

**SUBMITTAL TO THE BOARD OF SUPERVISORS
COUNTY OF RIVERSIDE, STATE OF CALIFORNIA**



FROM: Executive Office

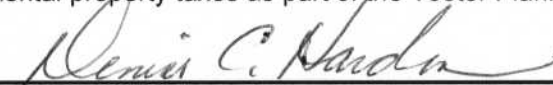
SUBMITTAL DATE:

June 24, 2005

SUBJECT: Report on Surplus Cash Balance in the Teeter Debt Service Fund

RECOMMENDED MOTION: That the Board of Supervisors:

- A. Receive and file the attached report by the County Executive Office of the review of the surplus cash balance in the Teeter Debt Service Fund; and,
- B. Approve the Executive Office's recommendations contained in that report:
 1. That the Executive Office and the Auditor-Controller proceed with finalizing the amount of non-delinquent prior year supplemental property taxes owed to the participants, presently estimated at \$73.8 million.
 2. That the Executive Office transfer the estimated amount from the Teeter Debt Service Fund to the Teeter Tax Resources Fund by June 30, 2005.
 3. That on receipt of that amount into the Teeter Tax Resources Fund the Auditor-Controller distribute the amount to the appropriate Teeter participants.
 4. That the County issue sufficient debt to cover the full amount of cash required for this transfer, thus restoring the debt to the appropriate level.
 5. That the State Controller's accounting guidelines noted by Vavrinek, Trine, Day & Co., LLP, be implemented to provide improved management information and decision support.
 6. That the County discontinue including supplemental property taxes as part of the Teeter Plan.



 Denise C. Harden, Principal Management Analyst

FINANCIAL DATA	Current F.Y. Total Cost:	\$ NA	In Current Year Budget:	NA
	Current F.Y. Net County Cost:	\$ NA	Budget Adjustment:	NA
	Annual Net County Cost:	\$ NA	For Fiscal Year:	NA

SOURCE OF FUNDS: NA	Positions To Be Deleted Per A-30	<input type="checkbox"/>
	Requires 4/5 Vote	<input type="checkbox"/>

C.E.O. RECOMMENDATION: APPROVE.

County Executive Office Signature 

Dept't Recomm.: Consent Policy
 Per Exec. Ofc.: Consent Policy

Prev. Agn. Ref.: 02/01/05 #3.34
 05/03/05 #3.45

District: _____ Agenda Number: **3.65**

Departmental Concurrence

Form 11

Subject: Report on Surplus Cash Balance in Teeter Debt Service Fund

June 24, 2005

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BACKGROUND: As reported in the Mid-year Budget Report to the Board of Supervisors presented on February 1, 2005, the Executive Office, together with the Treasurer-Tax Collector's and Auditor-Controller's Offices, has been examining the possible causes of a growing cash balance in the County's Teeter Debt Service Fund. The Executive Office engaged the County's external auditor to review certain procedural questions as part of our review.

The attached report is a summary of our findings, conclusions and recommendations. The external auditor's report to the Executive Office, as well as the Auditor-Controller's response to it, are attached. The Auditor-Controller's responses were incorporated into the report where appropriate and relevant. The Executive Office report concludes that non-delinquent prior year supplemental property taxes owed to participating Teeter agencies were deposited to the Teeter Debt Service Fund in error throughout the history of the Teeter Plan, resulting in a surplus cash balance.

The Executive Office reviewed 11 years of transaction activity in the Teeter Debt Service Fund and the Teeter Tax Resources Fund, and estimate \$73.8 million needs to be distributed to the Teeter participants. This estimate was reviewed and validated by the Auditor-Controller's staff on June 24, 2005. The Executive Office recommends transferring the estimated amount owed into the Teeter Tax Resources Fund for distribution by the Auditor-Controller. The Executive Office will also work with the Auditor-Controller to finalize the estimate.

**TEETER DEBT SERVICE FUND
CASH BALANCE ANALYSIS**

EXECUTIVE SUMMARY

The staff of the Executive Office, Treasurer-Tax Collector's Office and Auditor-Controller's Office identified an unexpected cash balance in the Teeter Debt Service Fund and initiated an internal review. As part of this review, the 11-year transaction activity in the Teeter funds was reviewed and analyzed. Various scenarios why such a cash surplus could develop were explored to rule out the possibility of data entry or other errors. In October 2004, the Auditor-Controller presented the Executive Office their theories and recommendations, including a proposal to immediately move and disburse a portion of the balance on hand. The Executive Office requested additional information from the Auditor-Controller, took the matter under advisement, and determined to engage the assistance of the county's external auditor in December 2004.

In summary, the essential facts regarding this matter are:

- The Teeter Plan was established to borrow money to cover the delinquent property taxes of participating taxing agencies. The county assumes the risk of collecting the delinquent taxes and paying back the loans.
- When the plan was established, it was generally assumed by all parties at the county that it was both appropriate and necessary to cover delinquent supplemental property taxes under the plan. However, including non-delinquent taxes was *not* contemplated.
- Annually, the Auditor-Controller runs a process to determine the amount of delinquent property taxes for which to borrow and distribute to the Teeter participants.
- The Treasurer-Tax Collector collects property taxes and transfers the receipts to the Auditor-Controller.
- The Auditor-Controller distributes the receipts, depositing the prior year receipts of Teeter participants to the Teeter Debt Service Fund. The Executive Office pays debt service from taxes deposited by the Auditor-Controller.
- The prior year receipts of supplemental property taxes the Auditor-Controller deposits to the Debt Service Fund included both delinquent and non-delinquent receipts.
- Unaware that the prior year supplemental receipts included both delinquent and non-delinquent amounts, the Executive Office applied those receipts to debt service. Implementation of both GASB 33 requirements and the new financial system caused procedural changes in the Executive Office which brought the issue to light.
- The Executive Office estimates that \$73.8 million in non-delinquent prior year supplemental property taxes were not distributed to the participating taxing agencies, but were inadvertently applied to pay down Teeter Debt Service, and is owed to the participating taxing agencies. That amount should be distributed by the Auditor-Controller.

ANALYSIS

INTRODUCTION

In October 2004, the Auditor-Controller posed theories that the method they use to calculate the amount of supplemental property taxes to deposit to the Debt Service Fund included both delinquent and non-delinquent prior year supplemental property taxes. However, the method they use to calculate the amount for which to borrow and to distribute annually under Teeter included only the delinquent amount. Consequently, the amount of supplemental taxes deposited into the Teeter Debt Service Fund was larger than the amount borrowed and distributed, causing an unexpected balance. The solution the Auditor-Controller proposed was to immediately distribute the related portion of the cash balance as part of the FY04/05 supplemental property taxes, and to change their method of calculating the amount to borrow to include non-delinquent prior year supplemental property taxes.

The Executive Office worked to validate and verify those suppositions and the effects of the Auditor-Controller's theories and recommendations, and asked the Auditor-Controller to provide additional information by mid-November. In December, the Auditor-Controller met with the Executive Office staff to propose distributing a portion of the cash balance on hand, and the Executive Office took the information under advisement.

The Executive Office recognized then that any amount owed in arrears to any participating taxing agency was important. The goal of our review was not to distribute cash quickly, simply for the sake of taking immediate action, but to completely and thoroughly analyze the total amount owed so the entire matter could be dealt with and settled properly at one time.

To obtain independent assistance, the Executive Office engaged the county's external auditor, Vavrinek, Trine, Day & Co, LLP (VTD), to do an agreed-upon procedures report on particular procedural questions raised during the Executive Office's review (see Attachment A). Under rules of professional auditing conduct, VTD is prohibited from providing further types of consulting services because they also perform official auditing services for the county. The agreed-upon procedures report was conducted for the Executive Office within these constraints. The knowledge and expertise in the county's property system that VTD brought to the effort through their role as our external auditor was invaluable to this study.

SUPPLEMENTAL PROPERTY TAXES

Supplemental property tax bills are generated monthly on a rolling basis as changes in ownership or status of property are assessed. Payments are due to the county on a schedule prescribed by state law. Unlike regular property taxes, which are collected and apportioned by a few fixed dates each year, supplemental property taxes are due on a rolling basis each month throughout most of the year.

While all regular property taxes are due and payable within the fiscal year in which they are billed, it is possible that supplemental property taxes may be billed in one fiscal year, but have one or both installments due and payable in the next fiscal year. In financial accounting terms, taxes owed in the fiscal year in which they are billed are booked as "current" tax revenues. Once they become due after the year in which they were billed, they are booked as "prior year" revenues.

If not paid by June 30 of the fiscal year billed, regular property taxes become delinquent. Consequently, all unpaid prior year regular property taxes are by definition delinquent. However, this rule does not apply to supplemental property taxes. Because payment schedules for supplemental property taxes may cross fiscal years, prior year supplemental property taxes may or may not be delinquent.

NON-DELINQUENT VERSUS DELINQUENT SUPPLEMENTAL PROPERTY TAXES

After extensive analysis, and in taking into account the findings of the county's external auditor, the Executive Office concurs with the Auditor-Controller on the point that certain cash in the Teeter Debt Service Fund is attributable to their deposits of non-delinquent prior year supplemental property taxes into that fund. We further confirm it is not currently possible to distinguish non-delinquent from delinquent prior year supplemental property taxes once they post to the county's financial system, due to the way in which those receipts are booked. We did not pursue why they are booked in that manner as part of this study.

Since the beginning of the Teeter Plan, Executive Office staff applied taxes deposited by the Auditor-Controller's Office to the Teeter Debt Service Fund to pay debt service on the loans that cover the delinquencies of the participating taxing agencies, and therefore paid debt service with the non-delinquent supplemental property taxes deposited into that fund. In a number of cases, this resulted in a perfect zeroing out of the existing cash balance at the time debt service was paid. Consequently, from the beginning, the participating taxing agencies, including the county, did not receive their full share of non-delinquent supplemental property taxes, and the county paid down the Teeter debt too quickly, using receipts that should have been distributed.

Over most of the period at issue, supplemental property tax revenues averaged no more than approximately 10 percent of the program. Consequently, at inception, they were considered a minor component of the overall program, and the issue was not analyzed extensively. Only with the recent unprecedented growth in property tax values and consequent rise in supplemental receipts did the significance and magnitude of the issue become apparent.

ACCOUNTING PROCEDURES

A key question for the external auditor was whether appropriate accounting procedures were being followed, and if not, could that be a contributing factor. This is a standard question of any review of this type. Consequently, VTD was asked to render findings on

several procedural questions: what are the applicable generally accepted accounting procedures; what procedures are the county following; and, how do these differ?

VTD found that the State Controller's guidance suggests receivables for property taxes be recorded in the county's financial ledgers when the Auditor-Controller enrolls the levy. In the case of regular property taxes, this would occur once a year when the levy is enrolled, with periodic adjusting entries at appropriate times to account for ongoing adjustments to the roll. With supplemental property taxes, it would be monthly when the Auditor-Controller enrolls the supplemental property taxes. VTD found that what the county is actually doing is recording receivables once a year for the amount delinquent.

The Auditor-Controller's Office was provided and briefed on VTD's preliminary draft report on June 1, and the Executive Office received their response on June 21 (see Attachment B). The Auditor-Controller's response to this finding is that the State Controller's guidelines are only guidance, and not legal requirements. He states that the state has reviewed the county's property tax distribution system, and deemed it in compliance with state regulations. The Auditor-Controller further states that in the end both the State Controller's guidance and his office's current practice reflect the same result.

From a financial reporting standpoint, the net result should be no different, if the supporting systems function properly. However, from a practical standpoint, as well as a management information standpoint, not having the receivables recorded when the taxes are enrolled means there is no yardstick against which to measure transaction activity throughout the year. Put simply, it also means there is no standard accounting convention in place to provide staff with the proper guidance and context with which to handle the receipts, which contributed to the problem. Consequently, the discrepancy between the expected receivables and actual receipts could go undetected because there was no basis against which to measure the financial activity. Therefore, the Executive Office recommends compliance with the State Controller's guidance noted by VTD on this point.

On this point, the Auditor-Controller also argues that the constraints of the property system itself limits their ability to implement this guidance, as they believe the necessary data are unavailable to them. The Executive Office explored this question at great length, and did not find this to be the case. The Executive Office did not find any systems limitations that prevent the Auditor-Controller from determining the aggregate amount of the property tax levy. Furthermore, the Executive Office documented that the necessary roll change data are available on a daily basis, as corroborated by reports produced daily for the Treasurer-Tax Collector's staff, and by the Teeter reconciliation reports provided by the Auditor-Controller over most of the history of the Teeter Plan.

The Executive Office recognizes that the Auditor-Controller has not had the same level of access to and control over their applications developers that the Treasurer-Tax Collector has, and this may have been a contributing factor to their understanding of the

data available to them in the property system. This is one of several factors considered as part of the budget process in recommending the Auditor-Controller's request for positions to bring their applications development into their own department. However, the Executive Office did not find the technology of the property system itself to play any factor in this issue.

The Executive Office further believes the State Controller's Office provides valuable guidance on this point which, while not legally required, makes good sense and should be implemented effective in FY 2005-06.

Another question that arose was whether changes in accounting practices and procedures over the years might have contributed to the problem. VTD analyzed the trial balances for both the Teeter Debt Service Fund and the Teeter Tax Resources Fund to identify trends in the accounting procedures used. They documented a number of fund conversions and procedural changes which generated considerable transaction activity in some years. VTD found these changes contributed considerably to the challenges of analyzing the transactional data. Their findings point to areas in which the county can strengthen its accounting practices. Several of these areas were already identified and addressed by staff.

BORROWING FOR NON-DELINQUENT SUPPLEMENTAL PROPERTY TAXES NOT SUPPORTABLE

The question also arose whether it is necessary and appropriate to issue notes for the non-delinquent unpaid supplemental property taxes as the Auditor-Controller suggests. There are several reasons this is not supportable. Two are rather technical, but important considerations nonetheless. One is that the Teeter Plan essentially buys out past due receivables, with those past due receivables themselves being the collateral. Although in practical terms Teeter allows the payments to roll in naturally, the idea is that the collateral backing the notes in the form of past due tax bills could be called and recovered under the law regarding delinquencies.

However, a significant portion of the supplemental property taxes do not fall in this category, as they are not delinquent. While they are receivables, they are not past due receivables, and are not immediately recoverable collateral the way in which delinquent taxes are. This would likely pose a problem with respect to borrowing.

Another issue stems from the fact they are not past due receivables, but due at some future point. In such a circumstance, distributing them via Teeter notes would, in effect, advance revenue to the jurisdictions for taxes not yet due to be paid to the Treasurer-Tax Collector. If notes were issued in August, for example, this would advance revenue to the jurisdictions not due the Treasurer-Tax Collector until November, and allocable by the Auditor-Controller to jurisdictions until December.

The third issue is simply timing. The non-delinquent unpaid supplemental property taxes due when the extract runs against the year-end closing figures represent six out of twenty-four installments that occur during the billing cycle. The Treasurer-Tax

Collector will receive four of these installments between the end of July and the end of October, and two in November.

The Teeter notes typically issue in October. If the extract is run against non-delinquent unpaid supplemental property taxes in mid-July, and the notes issue in October, then by the time the notes are actually issued, four out of the six installments of non-delinquent prior year supplemental property taxes will have already been paid to the Treasurer-Tax Collector, and it is not necessary to issue debt in order to distribute them, as the cash is already in hand. Issuing notes for those installments only doubles the amount of cash necessary, rendering that portion of the debt redundant. The remaining two installments are only within a month of collection. The problems with issuing debt against those two installments are covered above.

WHAT IS OWED TO THE TEETER PARTICIPANTS

It should be noted that, due to the depression in the real estate market during the early years of the Teeter Plan, the total amount of supplemental property taxes deposited annually to the Teeter Debt Service Fund was quite modest. For several years, this total amount was no more than a few million dollars a year, which, when spread across eleven hundred participating taxing entities, could not be characterized as a substantial windfall.

After review of the financial records, the Executive Office estimates that a total amount of \$73.8 million in non-delinquent supplemental property taxes deposited to the Teeter Debt Service Fund needs to be transferred to the Teeter Tax Resources Fund to be distributed by the Auditor-Controller to the taxing agencies. This amount was estimated by taking the sum of all deposits of supplemental property taxes deposited to the Teeter Debt Service Fund and subtracting from that total the sum of all of delinquent supplemental property taxes distributed. To summarize:

Prior Year Supplementals Deposited to the Teeter Debt Service Fund	\$105.6 m
Less Delinquent Supplementals Distributed From the Teeter Tax Resources Fund	<u>- 31.8 m</u>
Estimated Amount of Non-delinquent Supplementals Owed	= \$ 73.8 m

This estimate is assumed to be the most accurate means possible by which to determine the amount of non-delinquent supplemental property taxes deposited to that fund.

The Auditor-Controller publicly raised the issue of whether a statute of limitations provided for under Revenue and Taxation Code §96.19 might prohibit his office from distributing the entire amount. This section of the code state, in full:

Notwithstanding any other provision of law, the property tax apportionment factors applied in allocating property tax revenues in the county of Riverside for each fiscal year to the 1999-2000 fiscal year, inclusive, are deemed to be correct. However, for the 2000-01 fiscal year and each fiscal year thereafter, property tax apportionment factors applied in allocating property tax revenues in the County of Riverside shall be determined on the basis of property tax apportionment factors for prior fiscal years that have been fully corrected and adjusted, pursuant to the review and recommendation of the Controller, as would be required in the absence of the preceding sentence.

It should be carefully noted that this section of the code pertains specifically, and exclusively, to the County of Riverside's apportionment factors, which are not an issue in this case. The Executive Office consulted with County Counsel, and it is Counsel's opinion that this particular statute does not prohibit the Auditor-Controller from making the necessary distribution of the amount owed.

CONCLUSIONS

The Executive Office validated that non-delinquent prior year supplemental property taxes should not have been deposited to the Teeter Debt Service Fund in the past, and that any cash currently present in that fund from that source should be transferred to the Teeter Tax Resources Fund and distributed by the Auditor-Controller to the appropriate Teeter participants. Furthermore, the Executive Office also finds that not only such cash on hand should be distributed, but that the total amount of non-delinquent prior year supplemental property taxes deposited to that fund since the beginning of the Teeter Plan should be transferred and distributed appropriately.

With regard to the Auditor-Controller's proposal to change their extract to capture data on both non-delinquent as well as delinquent prior year supplemental property taxes, the Executive Office recommends an alternate approach. The Executive Office finds no basis in the Teeter Plan in which it is appropriate to borrow in order to advance non-delinquent property taxes of any type to participating agencies. Furthermore, the Executive Office finds no need to do so, even if it were appropriate, given that nearly the entire balance of non-delinquent supplemental property taxes is collected by the time the Teeter borrowing occurs.

During this review the Auditor-Controller raised the question of who should provide the delinquency data for this process. The Auditor-Controller maintains it is the Treasurer-Tax Collector's responsibility to provide the delinquency totals to the Executive Office, and claims to be running the extract as a favor to the Executive Office because the Treasurer-Tax Collector will not do it.

However, the Executive Office discussed this issue in depth with the Treasurer-Tax Collector's Office, and confirmed it is not possible for them to provide this data. They cannot break out the sub-total just for the Teeter participants needed by the Executive

Office and Auditor-Controller, since that is a function of the apportionment procedures, which are legally the jurisdiction of the Auditor-Controller. This is a core issue of separation of powers. Consequently, the Executive Office finds no basis on which to expect the Treasurer-Tax Collector to provide information on the amount of Teeter receivables outstanding. Furthermore, if the receivables are booked by the Auditor-Controller when they enroll the levy, then the point will be moot, since the remaining receivable would be apparent from the balance sheet.

On the question of whether supplemental property taxes should be included under the Teeter Plan or not, the Executive Office concludes that if there are no feasible procedural changes on the part of either the Treasurer-Tax Collector or the Auditor-Controller, or both, which can distinguish the non-delinquent from delinquent prior year supplemental property tax receipts, then supplemental property taxes should not be included under Teeter at all. This conclusion is supported by documentation presented by VTD, which clearly shows the statutes governing Teeter are permissive on this point, stating only that supplemental property taxes *may* be treated the same as regular property taxes, but not requiring that they be.

RECOMMENDATIONS

The Executive Office recommends the following plan of action:

1. That the Executive Office and Auditor-Controller proceed with finalizing the amount of non-delinquent prior year supplemental property taxes owed to the participants, presently estimated at \$73.8 million.
2. That the Executive Office transfer the estimated amount from the Teeter Debt Service Fund to the Teeter Tax Resources Fund by June 30, 2005.
3. That on receipt of that amount into the Teeter Tax Resources Fund the Auditor-Controller distribute the amount to the appropriate Teeter participants.
4. That the county issue sufficient debt to cover the full amount of cash required for this transfer, thus restoring the debt to the appropriate level.
5. That the State Controller's accounting guidelines noted by the Vavrinek, Trine, Day & Co., LLP, be implemented to provide improved management information and decision support.
6. That the county discontinue including supplemental property taxes as part of the Teeter Plan.



INDEPENDENT ACCOUNTANT'S REPORT
ON APPLYING AGREED-UPON PROCEDURES

To the County Executive Office
County of Riverside, California

We have performed the procedures enumerated below, which were agreed to by the County of Riverside, solely to assist you in analyzing transaction activity in the Teeter Debt Service and the Tax Resources Funds. The County of Riverside's management is responsible for the Teeter Debt Service and Tax Resource Funds. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

1. Identify acceptable accounting procedures to track the receivable bought out under the Teeter Plan. Consider generally accepted accounting principles (GAAP) and accounting guidance issued by the California State Controller's Office (SCO).

The procedure above is to identify acceptable accounting procedures to track receivables purchased by the County under the Teeter plan. The County's existing procedures for tracking the receivable buy-out are identified in procedure #2. The County's conformity with procedures identified under GAAP or the SCO's office are discussed in procedure #3.

The receivables bought out under the Teeter Plan represent the principal taxes levied, adjusted for roll corrections, which are apportioned to Teeter taxing entities in advance of actual cash collections.

Under GAAP, Governmental Accounting Standards Board (GASB) Statement No. 33, the County should record a receivable for property taxes when an enforceable legal claim to the resources exists. Therefore, the County has a property tax receivable at the time of levy.

Under the Teeter Plan, the County is required to apportion the levy, as adjusted, regardless of the timing of cash collections received. Therefore, at year-end, the County has a liability owed to participating Teeter taxing entities in the amount of the adjusted levy not apportioned.

As a result, the County should record a receivable for the property taxes levied and amounts owed to Teeter Plan participants at the time of the current year levy. This transaction could appear in the tax resources fund as follows:

Debit - Current Year Taxes Receivable

Credit - Due To Others (funds or governments)

(To record the taxes receivable and owed under the Teeter plan at the levy date)

It is noted that under GAAP, the administration of property taxes, represents a fiduciary relationship between the County and local government agencies. The County collects and apportions property taxes on behalf of it and other government agencies. Therefore, cash receipts from property taxes and payments to local government agencies are not revenues or expenditures of the County. This same concept is applicable to taxes under the Teeter plan.

The SCO's Accounting Standards and Procedures for Counties manual dated May 2003 prescribed guidelines for the Alternative Method of Tax Apportionment. Under these guidelines, the County is required to maintain a Tax Resources Fund (TRF). The TRF identifies taxes owed, received and apportioned to Teeter participants. As prescribed by the SCO, the following events require accounting transactions:

- *Levy of taxes – At the levy, the County should record the taxes receivable and the amounts payable to participating agencies.*
- *Apportionment of taxes based on levy – When tax apportionments occur, payables decrease for cash payments to participating agencies.*
- *Receipts of redemption payments (taxes collected) – Tax receipts applicable to Teeter reduce the taxes receivable established at the time of levy.*

Using the SCO guidelines described above, suggested accounting procedures for the TRF are summarized on Attachment A.

2. *For fiscal year 2004/2005, document the accounting procedures being utilized. In documenting the accounting procedures, conduct interviews of staff in the Executive Office and Auditor-Controller's Office (ACO) and review existing policies and procedures.*

We conducted interviews with staff in the Executive Office and the ACO and obtained documented procedures over the flow of accounting transactions. As a result, the following was noted:

- *The County apportions current year taxes collected to Teeter participants during the fiscal year. At year-end, the County generates a Teeter "Unpaid Extract" to identify the amounts owed to each Teeter participant.*
- *The "Unpaid Extract" identifies the current year property tax assessments that are delinquent as of year-end by taxing entity. Therefore, the County utilizes the delinquent secured and supplemental property taxes at year-end as the basis for identifying the amounts owed to participating agencies under Teeter.*
- *The County finances the amounts identified in the "Unpaid Extract" due to Teeter participants through short-term Teeter notes. The County records the activity related to the notes in the Teeter Debt Service Fund.*
- *At Teeter note issuance, the County records a receivable in the Teeter Debt Service Fund and the cash proceeds in the TRF. The liability associated with issuing the notes is recorded in the Teeter Debt Service Fund.*
- *Financing for the Teeter buy-out occurs subsequent to the fiscal year-end. Therefore, the County records the receivable for the delinquent taxes outstanding at the time cash apportionments are made to the participating taxing entities.*

- *Cash proceeds collected on the principal of delinquent secured taxes are recorded in the Teeter Debt Service Fund. Delinquent and non-delinquent supplemental taxes, related to Teeter are also recorded in the Teeter Debt Service Fund. Penalties and interest on delinquencies are deposited in the Tax Loss Reserve Fund. The County pays debt service principal from the deposits in the Teeter Debt Service Fund. Transfers from the Tax Loss Reserve Fund pay for interest expenses and financing costs.*

The documented accounting procedures utilized for fiscal year 2004/2005 are summarized on Attachment B.

For fiscal year 2004/2005, the trial balances as of March 31, 2005, reflect an interfund receivable/payable between the Tax Resources Fund and the Teeter Debt Service Fund. The interfund balance represents an exchange of cash in prior years that has not been repaid or adjusted.

3. Are the accounting procedures in procedure #2, consistent with procedures or methods identified in procedure #1?

The accounting procedures in procedure #2 include the use of the Teeter Debt Service Fund to track and identify accounting activity related to the issuance of debt to finance the Teeter buy-out at year-end. The creation of the Teeter Debt Service Fund provides a mechanism to track the Teeter notes outstanding and debt service and does not present an accounting discrepancy. Under the guidelines provided by the SCO, the cited examples do not consider the use of debt in financing the Teeter obligation and therefore do not reference additional funds. However, the use of the Teeter Debt Service Fund is acceptable under GAAP.

Individual entries representing differences in accounting mechanics for recording taxes receivable differ because in procedure #1, the SCO procedures suggest that taxes receivable and related payables be recorded at the time of levy. In procedure #2, the County records taxes receivable at the final Teeter apportionment, when the actual purchase of delinquent taxes occurs. This is further detailed below:

- *In procedure #1, the SCO accounting for taxes receivable occurs on a "gross" basis. Under this methodology, the receivable at the time of levy is recorded and all cash receipts and adjustments are directly applied. At year-end any amount of the outstanding taxes receivable not apportioned, requires apportionment to participating Teeter taxing entities.*
- *In procedure #2, the County apportions the collection of current year taxes to Teeter and non-Teeter participants based on cash collections. The apportionments occur directly from the tax trust funds to the appropriate County fund or jurisdiction. Ongoing transactions do not flow through the TRF except for the actual receivable buy-out.*
- *In procedure #2, the County utilizes the property tax system to identify delinquent secured and supplemental taxes in an "Unpaid Extract" at the end of the fiscal year. The "Unpaid Extract" becomes the basis for the taxes owed under Teeter and this amount is recorded as a receivable subsequent to year-end. Property tax receipts subject to Teeter, identified as "Prior Year Collections" are applied to the receivable generated from the "Unpaid Extract."*

4. Analyze the trial balances for the Teeter Debt Service Fund and Tax Resources Fund over the past eleven-year history and identify the consistency or trends in accounting procedure utilized.

Over the past eleven year history of the Teeter Debt Service and Tax Resources Funds it was noted that accounting procedures varied each year causing discrepancies in receivable and payable accounts. Trends and inconsistencies are identified below:

- *In 1993-94, the County established the accounting flow in two funds, T99- CORAL TEETER and T01-TAX RESOURCE.*
 - *In T99, cash proceeds from the issuance of notes and the issuance of debt were recorded by directly adjusting fund equity.*
 - *Cash receipts from supplemental and secured apportionments to the T99 fund were used for the payment of debt service on notes. Further, the cash collections reduced taxes receivable to reflect a decrease in the amount outstanding. However, it was noted that approximately \$17 million in tax receipts were received that were not recorded to taxes receivable causing the receivable to be overstated.*
 - *In T01, cash proceeds were recorded in an equal amount to the issuance of notes in T99. The cash proceeds in fund T01 was reduced when the Teeter apportionment occurred. All corresponding cash entries were offset by transactions to equity.*
- *In 1994-95, the County applied similar accounting procedures to 1993-94 except that mis-postings to taxes receivable resulted in a negative balance of \$7 million in fund T01.*
- *In 1995-96, "Due to other government" accounts were created in fund T01. The County created the accounts to reflect the amount owed to Teeter participants at year-end.*
- *In 1996-97, transactions related to the issuance of notes and recognition of proceeds appear inconsistently posted from previous years as the receipts were applied to taxes receivable when no corresponding receivable was established. The ending account balance of taxes receivable was approximately \$41 million.*
- *Commencing in 1998-99, proceeds from the issuance of notes were no longer recorded directly in the T-99 CORAL Teeter fund. The County recorded cash proceeds directly in the Tax Resources fund. Further, the issuance of notes could not be identified in either trial balance for the fiscal year.*
- *Fiscal Year 1999-00 – The Teeter Fund (T01) is closed and is replaced by the Teeter Debt Service Fund (Fund 2502). Numerous adjustments, corrections and transfers were posted in the fund creating difficulties in the analysis of accounting flow and net activity. For example, in the Teeter Debt Service Fund, tax penalties were posted when such activity should have been recorded in the Tax Loss Reserve Fund.*
- *It was noted that cash proceeds received in the Teeter Debt Service fund since 1993-94 were used as repayment for notes outstanding. Commencing in fiscal year 2000-01, the County utilized cash balances in the Teeter Debt Service Fund to pay interest and financing costs in addition to principal debt service.*

- *Commencing in 1998-99, the issuance of notes and receipt of cash proceeds used in the Teeter buy-out occurred progressively later in the fiscal year. Before 1998-99, the issuance of notes occurred in August or September. Subsequent to 1998-99, the issuance of notes occurred in October and November.*

5. Determine, using the California Revenue and Taxation Code what considerations or items are noted with respect to handling supplemental taxes?

In Section 4700 of the California Revenue and Taxation Code (R&T) the following considerations with respect to supplemental taxes were noted:

- *R&T Section 4701(b) – “For the purpose of this chapter only [Chapter 3], the term “secured roll” may include the supplemental property tax roll as described in Chapter 3.5 Section 75.” This reference suggests that the inclusion of supplemental taxes under the Teeter program is optional and therefore not a requirement.*
- *R&T Section 4705 (a) – “Upon completion of the tax roll as prescribed by Section 2152, the county auditor shall determine the total amount of taxes actually extended thereon for each fund for which a tax levy has been included. The amount so determined for each fund shall forthwith be apportioned to the credit of those funds on the accounts of the county auditor and county treasurer and the total thereof shall be entered on the apportioned tax resources accounts of both officers”. This suggests that the recognition of the amount owed under Teeter occur at the completion of the roll (i.e. levy).*
- *R&T Section 4705 (d) – “The board of supervisors shall provide which moneys in the county treasury, including but not limited to those credited to the tax losses reserve, shall be available to be drawn on to the extent of the amount of uncollected taxes credited to each fund for which a tax levy has been included, and those moneys may thereafter be drawn against in an amount not to exceed the amount of uncollected taxes credited to each fund for which a tax levy has been included in the same manner as if the amount credited had been collected.”*

It is further noted that the code section states that any amounts received, where an advance occurred from proceeds of notes, such amounts shall be used for the repayment of the notes. This code section suggests that the availability of resources drives the timing of when apportionment to Teeter participants is performed. Therefore, apportionment could occur at the time of levy, during the year or after the fiscal period.

- *R&T Section 4708 – “Amounts received on the secured tax roll for the current year shall be distributed on the accounts of the auditor and treasurer as follows...” Per R&T Section 4708(b), “Any amounts which were apportioned to funds at the time of the levy in the manner authorized by this chapter shall be distributed to the apportioned tax resources accounts.” This section suggests that the cash flow of the apportionment may not occur at the time of levy.*

In Section 75 of the California Revenue and Taxation Code (R&T) the following considerations with respect to supplemental taxes were noted:

- *Supplemental taxes are assessed on a rolling basis as determined by the timing of the change in ownership or new construction. As set forth in R&T Section 75.52, supplemental taxes billed between the months of July through October are due in two installments, December 10 and April 10. Supplemental taxes billed during the months of November through June are due in two installments whereby the first installment is due on the last day of the month following the month when billed. The second installment is due on the last day of the fourth calendar month following the date that the first installment is delinquent.*
 - *As a result of the above, supplemental taxes become delinquent on a rolling basis during the fiscal year. Further, the collection of current supplemental taxes may occur over two fiscal year periods.*
6. Document the procedures currently used by the County in handling supplemental taxes under the Teeter program.

The Assessor's office initially processes supplemental assessments within the property tax system. At the beginning of each month, the property tax system produces an extract, which extends the supplemental tax, identifying the supplemental assessment number and the parent assessment.

Before the transmission of data to the Treasurer-Tax Collector's office, the ACO produces a series of system jobs, based on formalized monthly checklists/procedures. The system jobs are designed to identify errors in the transfer of data from the Assessor's office, reconcile batch totals of data, identify refunds on negative extensions and identify assessments less than \$10.

The Treasurer-Tax Collector's office processes cash collections and the ACO uploads the data from the property tax system on a monthly basis. The ACO identifies cash collections of the current year with an "S or B" apportionment code and prior year collections with a "Y or W" code. Current year and prior year collections are defined below:

- *Current year collection – Assessed and collected within the same fiscal year*
- *Prior year collection – Assessed in one fiscal year and collected in the subsequent fiscal year*

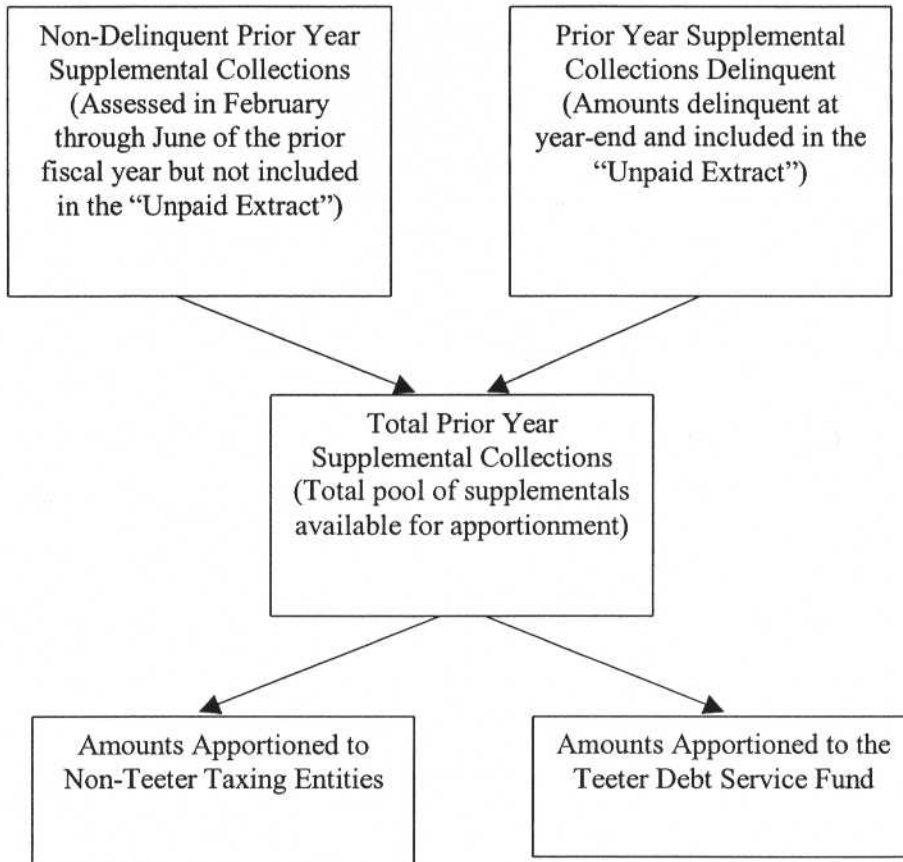
For apportionment, the ACO performs a series of system jobs to calculate and identify the amount of taxes collected requiring apportionment. In the property tax system, receiving taxing entities (local government agencies) are identified as being Teeter or non-Teeter. This designation identifies the taxes paid during the fiscal year to Teeter participants and the amounts outstanding at the end of the fiscal year for the final "true-up" apportionments. For current year taxes collected, apportionments to Teeter and non-Teeter taxing entities are performed when cash is received. For prior year tax collections, the ACO posts apportionments to non-Teeter taxing entities based on apportionment factors and to the Teeter Debt Service Fund for Teeter participants.

At year-end, the Auditor's office generates the unpaid extract for supplemental bills for preparing the final "true-up" of amounts owed to Teeter taxing entities. The year-end unpaid extract related to supplemental taxes has program coding supporting calculations to identify the amount of supplemental taxes that are delinquent for the fiscal year. Therefore, the delinquent supplemental tax is the amount apportioned to the Teeter taxing entities.

As a result of the above, there is a difference in the expectation between the apportionment as it relates to prior year supplemental taxes collected versus the amount used at year-end in the unpaid extract. The impacts are identified below:

- *Supplemental property taxes, applicable to Teeter, which are billed February through June and collected after fiscal year-end are considered prior year taxes and recorded in the Teeter Debt Service Fund.*
- *The year-end unpaid extract for supplemental taxes identifies delinquent supplemental taxes but not all unpaid supplemental taxes. Therefore, assessments billed in February through June are not identified on the supplemental unpaid extract. However, cash receipts collected in the subsequent fiscal year pertaining to assessments billed February through June are deposited to the Teeter Debt Service Fund.*
- *Supplemental bills outstanding from February through June are not included in the unpaid extract but the related payments collected (for Teeter participants) are deposited in the Teeter Debt Service Fund. As a result, the non-delinquent prior year supplemental property tax collections are not apportioned to Teeter taxing entities. Therefore, supplemental tax apportionments to Teeter taxing entities are understated.*
- *The County's procedures identify tax collections as current or prior year but not as delinquent. Therefore, when prior supplemental taxes are collected, those assessments billed in February through June (non-delinquent taxes) and delinquent taxes purchased under the Teeter plan are aggregated when deposited. When the County apportions the deposits, the aggregate receipts include assessments billed in February through June and delinquent taxes purchased under Teeter. On the trial balance, the deposits posted reflect the aggregate supplemental taxes received in the Teeter Debt Service Fund which include both non-delinquent taxes billed February through June of the previous fiscal year and delinquencies.*
- *The deposits in the Teeter Debt Service Fund, including delinquent and non-delinquent supplemental taxes, were used for the repayment of the principal of Teeter notes issued. As a result, amounts used for the payment of debt service should have been apportioned to Teeter taxing entities. Further, cash balances on hand would include deposits that were not apportioned to Teeter taxing entities.*

The current process is illustrated below:



7. Document the procedures followed throughout the eleven-year history of the Teeter Debt Service Fund and the Tax Resources Fund. Document changes in policies and procedures over this time period and note corrections, adjustments, and/or changes in procedures within this time period.

The accounting procedures followed throughout the eleven-year history of the Teeter Debt Service Fund and the Tax Resources Fund were not formally documented until May 2004. Therefore, changes in accounting practices are not discernable, except for the activity reported in the trial balances.

It was noted that the frequency of supplemental apportionments to taxing entities has varied from each fiscal year. For example, in 2003-04, supplemental tax apportionments were posted each month to the respective funds. However, in 1997-98, supplemental taxes were posted only in the year-end apportionment. Based on inquiry with staff in the Property Tax Division of the ACO, we were informed that the receipts of supplemental taxes were not deemed significant enough for monthly apportionment and therefore only apportioned on a limited basis. Therefore, supplemental taxes collected were accumulated and posted periodically instead of monthly. This procedure resulted in a lower frequency of apportionments but the nominal total remained unchanged. We obtained the final apportionment for 1997/98 and noted that the apportionment reflected monthly supplemental taxes collected throughout the entire fiscal year.

To the County Executive Office
County of Riverside, California
May 13, 2005
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We were not engaged to, and did not, conduct an examination, the objective of which would be the expression of an opinion on the Teeter Debt Service and Tax Resources Funds, its related internal control or the property tax system. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the County Executive Office of the County of Riverside and is not intended to be and should not be used by anyone other than these specified parties.

Vavermik, Tami, Day & Co., LLP

Rancho Cucamonga, California
May 13, 2005

County of Riverside
Tax Resources Fund Accounting Flow
May 13, 2005

Attachment A

<u>Event</u>	<u>Accounting Transaction</u>
a) <i>Levy of taxes</i>	
1)	Dr. Taxes Receivable - Current Year Cr. Due to others (General Fund or participating jurisdictions) -to record the levy of secured taxes
b) <i>Apportionment to Teeter Taxing Entities</i>	
2)	Dr. Due to others Cr. Cash -to record the apportionment of taxes under the Teeter Plan
c) <i>Receipt of Redemption Payments (Taxes Collected)</i>	
3)	Dr. Cash - Tax Principal Cr. Taxes Receivable - Current Year -to record the collection of taxes
d) <i>Reclassification for Delinquent Amounts</i>	
1)	Dr. Taxes Receivable - Prior Year Cr. Taxes Receivable - Current Year -to record the outstanding teeter amounts that are delinquent

Note:

a) *The entries summarized above do not consider interfund transactions or debt issuance for financing the Teeter apportionment*

b) *Penalties and interest associated with tax assessments are recorded in the Tax Loss Reserve Fund)*

c) *The accounting summarized above may be performed as a sub-fund of the General Fund or alternatively, as an agency fund*

County of Riverside
Teeter Buyout Procedures Currently Used in FY 2004-05
May 13, 2005

Attachment B

Event **Accounting Transaction**

a) *The County issues debt to finance delinquent property taxes for Teeter program participants*

Tax Resource Fund

Dr. Cash
 Cr. Due to Others

-the TRF records the proceeds of the debt to be used in the apportionment

Teeter Debt Service Fund (DSF)

Dr. Property Taxes Receivable—Delinquent
 Cr. Notes Payable
 Cr. Cash (to the extent that cash is used in addition to notes)

-the Teeter DSF records the receivable and debt obligation

Dr. Professional Fees
 Cr. Cash

-the Teeter DSF incurs costs for the issuance of notes, funded by the TLRP

b) *Distribute the unpaid taxes to make Teeter whole*

Tax Resource Fund

Dr. Due to Others
 Cr. Cash

-to record the Teeter reconciliation apportionment

c) *Apportionment of collection of prior year taxes to Teeter DSF*

Teeter Debt Service Fund

Dr. Cash
 Cr. Property Taxes Receivable—Delinquent

-to record the receipt of principal taxes on prior year amounts under Teeter

d) *Payment made on Teeter Notes*

Teeter Debt Service Fund

Dr. Bonds Payable
Dr. Interest Expense
 Cr. Cash

-to record the payment on Teeter Note principal and interest

County of Riverside
Teeter Buyout Procedures Currently Used in FY 2004-05
May 13, 2005

Attachment B, Continued

e) Penalties and interest from delinquent property taxes are deposited to the Tax Loss Reserve Fund as apportionments are made.

Tax Loss Reserve Fund

Dr. Cash
 Cr. Deferred Revenue
-to record prior year delinquencies and penalties to the Tax Loss Reserve Fund, based on apportionment

f) Transfer of Tax Loss Reserve Fund penalties to the General Fund

Tax Loss Reserve Fund

Dr. Deferred Revenue
 Cr. Cash
-to record the transfer of penalties and interest above the 1% reserve to the General Fund

General Fund

Dr. Cash
 Cr. Penalties and Interest Revenue
-to recognize income on prior year penalties and interest

g) Transfer of funds to TRF to cover costs of issuance and interest)

General Fund

Dr. Operating Transfer Out
 Cr. Cash
-to record the transfer out

Teeter Debt Service Fund

Dr. Cash
 Cr. Operating Transfers In
-to record the transfer in



Memorandum

Tel (951) 955-3800

Fax (951) 955-3802

To: Larry Parrish, CEO
From: Robert E. Byrd, County Auditor-Controller
Date: June 20, 2005
Re: Teeter Funds

On June 17, 2005, we received the draft report prepared by Vavrinek, Trine and Day (VTD) on Teeter Debt Service and the Tax Resource fund. The Auditor Controller's Office (ACO) has been working with the Executive Office (EO) for over a year in an attempt to verify the proper allocation and distribution of Teeter funds.

The ACO identified to the EO an increased amount over the initial requested amount to borrow for FY 2003-2004 under the Teeter program before the FY 2003-2004 distribution was made. This was based on the Auditor's identification of the discrepancy between unpaid supplemental taxes and delinquent supplemental taxes. Earlier fiscal year determinations are in the process and are hopeful to be completed prior to the next Teeter borrowing.

We have reviewed VTD's report on the agreed upon procedures and have the following responses.

1. While the State Controller's Office provides "guidelines" for Counties to follow, they are just guidelines and are not a legal requirement. Section 4703 of the revenue and taxation code provides the legal requirements for accounting and the mandated accounts required for such accounting. Our property tax distribution system has been reviewed by the State Controller's Office and has been deemed in compliance with State regulations.
2. The Accounting procedures described are appropriate.
3. Per the audit report the two methods described reflect in the same resulting amount. It was determined by all county offices involved in the initial setting up of the Teeter plan that due to the county's current property tax system constraints and unavailability of roll change data, that the currently used approach of determining the Teeter receivables at the end

of the year based upon the remaining unpaid assessments would be used and would meet the code requirements.

4. The ACO has been and will continue to work with the EO and the other tax related departments to the extent the system allows and will continue to apply newer accounting pronouncements and make necessary adjustments as needed.
5. The Code Sections referred to in the report apply.
6. The procedures in the report are appropriate. In early 2004, the problem of the difference between the "Unpaid" and "Delinquent" was identified by the ACO and the appropriate programming adjustments were made. The ACO requested additional funds for distribution, however, the amounts were withheld subject to the completion of the audit.
7. The procedures documented are appropriate.

We will continue to work with necessary departments to make sure that proper distributions are being made.